Transnationals

Quarterly Newsletter of the United Nations Centre on Transnational Corporations

INVESTMENT FLOWS $196 BILLION IN 1989

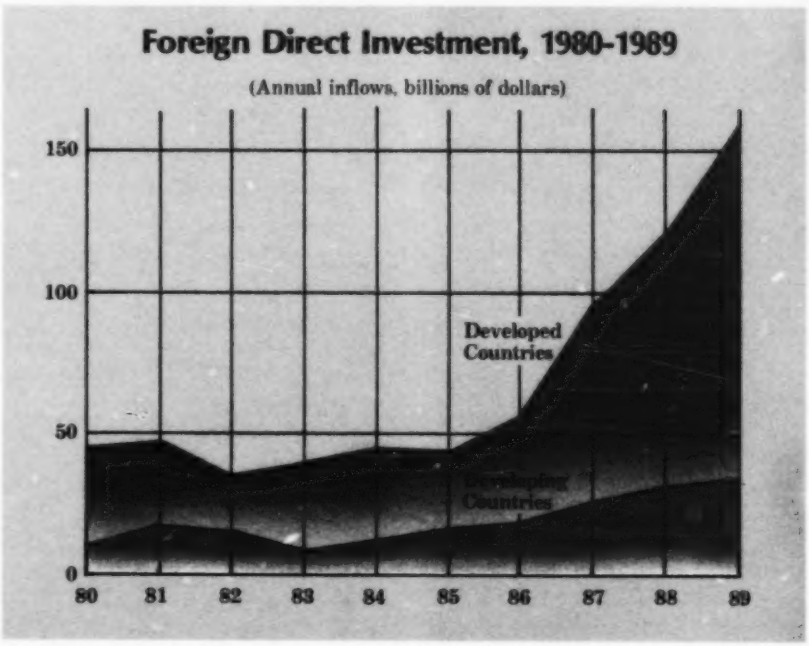
World-wide outflows of foreign direct investment continue to expand at a higher average annual rate than either world trade or world economic output. Growing by 20 per cent in 1989, investment flows reached a record $196 billion.

The stock of world investment is now nearly $1.5 trillion, representing a three-fold increase over the 1980-1989 decade. Much of this expansion took place in 1984-1987, largely among the developed countries (*see page 2*).

Investment flows to developing countries reached $30 billion in 1989, growing by about 16 per cent annually since 1984. Ten economies received about three fourths of developing country inflows in the 1980s: Singapore, Brazil, Mexico, China, Hong Kong, Malaysia, Egypt, Argentina, Thailand and Colombia.

Overall, net resource transfers through foreign direct investment to developing countries have shown a reversal from -$1.5 billion in 1980-1984 to $3.5 billion in 1985-1988. The positive transfer through foreign investment contrasts with negative transfers through private credit exceeding $30 billion in both periods.

Virtually all countries in Central and Eastern Europe have now passed legislation encouraging foreign investment. Joint ventures in Czechoslovakia, Hungary, Poland, Yugoslavia and the USSR multiplied to more than 9,000 by the end of 1990, from about 3,000 at the start. Few ventures are operational though; less than 10 per cent, for example, in the USSR. ■



Albania Opens to Foreign Investors

Now, for the first time in almost 50 years, foreign investors may do business in Albania, in joint ventures with state enterprises. The enabling Decree 7407 on the Economic Activity of Enterprises with Participation of Foreign Capital was enacted last July.

The decree provides the legal authority and basic rules for joint ventures between foreign investors and Albanian state enterprises. Explicitly targetted are ventures which modernize technology and management, generate or save foreign exchange and create jobs. The decree includes the right of dividend repatriation for the foreign partner and protection against expropriation. A related decree, Decision 228 on the Reorganization of Services and Artisan Production, allows local entrepreneurs to set up private businesses.

Already, some 30 joint venture proposals from foreign firms are

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Tripling of Global Investment Driven by Triad Competition

The tripling of world foreign direct investment in the 1980s was driven by intense corporate competition between a simple but powerful trio: the United States, the European Community and Japan — each trying to consolidate its own market while gaining a foothold in the other two.

This Triad, non-existent at the start of the decade, now accounts for 80 per cent of total outward investment stocks and flows, much higher than its corresponding 50 per cent share in world trade.

The Triad

In the early 1980s, global investment was bi-polar, dominated by the United States and a handful of Western European economies. But Japan's emergence as a leading foreign investor has added a third point. Accelerating EC integration also means that it is increasingly possible to conceive of the region as a single, integrated home and host region *vis à vis* the rest of the world.

The Triad accounts for 80 per cent of world investment, much higher than its corresponding 50 per cent share in world trade.

Japan is now the largest foreign investor, with outflows of $44 billion in 1989. Though primarily investing in the United States, Japanese companies are increasingly citing Europe as the region to target.

United States investment in Japan has grown rapidly over the last few years, though from a very small base. Flows to the EC, while large, have actually been falling. This is partly due to the strong position already attained by US corporations in the EC. United States firms do not face the same intense pressure to make new investments as the Japanese or to regionalize existing operations as the Europeans.

The EC owns the largest share — 48 per cent — of intra-Triad foreign direct investment stock. Most of this was held in the United States. However, the coming single market has provoked an unprecedented level of investments within the EC. The need to achieve economies of scale and consolidate regional distribution systems in the face of increasing global competition, has also prompted a number of cross-border acquisitions.

The United States is the largest host country, receiving nearly half of world investment every year since 1983. The EC was the largest investor there, accounting for $42 billion in outflows in 1989. However, with the opportunities created by regional integration, the EC could eventually surpass the United States as the most important host.

Investment Clusters

Accounting for four fifths of total global flows, the Triad was the main source of foreign direct investment to the rest of the world as well. In 30 developing and Cen-

1980s Investment Highlights

- **World foreign investment triples. Total global investment stock is now about $1.5 trillion. It was some $500 billion in 1980.**
- **The United States emerges as the most important host country.**
- **The European Community emerges as the most important home region.**
- **Japan expands overseas investment six-fold during the decade.**
- **Developing countries' share in global flows declines. In spite of a near doubling of average annual flows to developing countries, their share fell from 25 per cent to 17 per cent.**
- **Latin America accounts for 80 per cent of the declining share of developing countries' inflows. Some 40 per cent of the inflows of large debtors was through debt-equity swaps.**
- **The Asian newly industrialized countries emerge as increasingly important foreign investors.**
- **The least developed countries, including much of Africa, are marginal to global trends, now as before, in spite of sizeable policy reforms.**

tral and Eastern European countries studied, a single Triad member accounted for over half of total inward investment stocks and flows in the 1980s.

Within this overall pattern, the association of home and host countries has also shifted somewhat.

Investment flows suggest a pattern: host countries cluster around a single Triad member in the same geographic region.

The change, which is best captured in flows rather than in stocks, suggests a pattern whereby host countries cluster around a single Triad member in the same geographic region.

For example, the countries of Central and South America cluster around the United States; those of South-East Asia cluster around Japan. The opening of Central and Eastern Europe is leading to a similar clustering pattern in Europe: EC members accounted for half of the joint ventures in Hungary, Poland, Czechoslovakia and the USSR by the end of 1989.

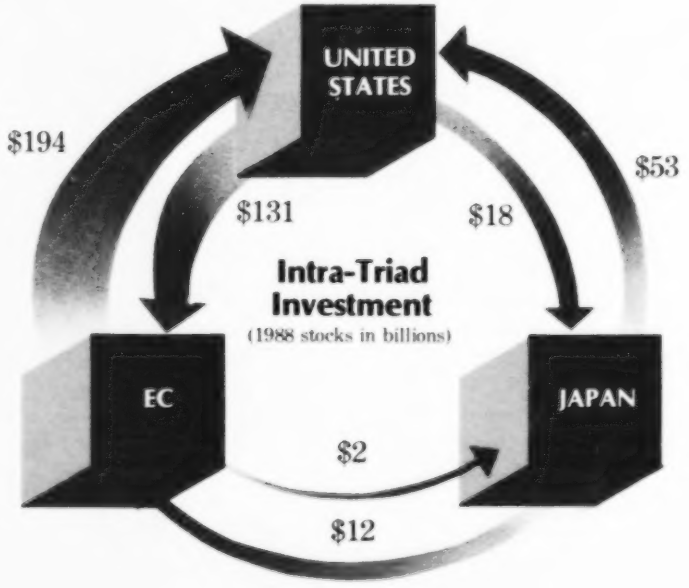
Regional Core Networks

Corporate efforts to attain global market share have worked to produce clustering. Many Triad corporations seem to be adopting a regional core network strategy: it involves building up integrated networks of affiliates in each of the Triad regions, with operations in the Triad member as the core.

In some cases, there appears to be a rise in the level of the value-added of overseas affiliates and in the latter's overall strategic importance to the parent company. This is especially the case with the Japanese affiliates in Asia and US affiliates in Mexico.

Intra-firm trade within the networks has also been instrumental in promoting exports from host countries. In most of these regional networks, new equity investments build on longstanding non-equity relationships, particularly subcontracting arrangements. Investments are aimed both at capturing local demand and at creating a production base from which to export to other countries.

If current trends continue, the role of EC firms in Central and Eastern Europe may come to resemble that of Japanese subsidiaries in Asia and US subsidiaries in Mexico. ■



The Triad in Foreign Direct Investment: Implications for Developing Countries. **UNCTC Current Study No. 21. Available in July 1991. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.**

Albania

(Continued from page 1)

under active consideration by the Albanian Government. They cover the petroleum, mining, minerals processing, tourism development, timber and building materials sectors, but concentrate particularly in petroleum exploration.

In mining, chrome is of the most interest to foreign investors. There appear to be reserves of copper, nickel, iron ore, bauxite and coal also, but only in moderate reserves and grades. More exploration is needed.

The decrees are among the first steps in a fledgling programme to liberalize the domestic economy. With UNDP financial support, UNCTC will provide assistance to Albania in developing the legislation necessary to govern foreign investments, including company, contract, income tax, property and foreign investment laws. UNCTC will also advise the Government in awarding petroleum exploration rights to foreign companies. ■

READEX FICHE

Eastern Caribbean: Human Resourc

Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis, Saint Lucia, Montserrat, and Saint Vincent and the Grenadines — which comprise the Organization of Eastern Caribbean States (OECS) — have recently embarked on a programme to attract foreign investors and build international competitiveness. But rather than offer the usual run of investment incentives, the OECS is giving new emphasis to human resource development and the upgrading of local technical and managerial know-how.

Over much of the 1980s, the OECS outperformed most other developing countries.

With production technologies growing in sophistication, skills and know-how are becoming an important determinant of international competitiveness. Much like wage rates or infrastructure, the technical and managerial "preparedness" of a country's labour is increasingly figuring in foreign investment decisions. The OECS experience is clear testimony to this.

Regional boom . . .

The seven-member OECS is a subregional group within the 12-nation Caribbean Common Market (CARICOM). With an average annual GDP growth of 5 per cent and levels of gross investment of 30 per cent over much of the 1980s, the OECS outperformed most other developing countries.

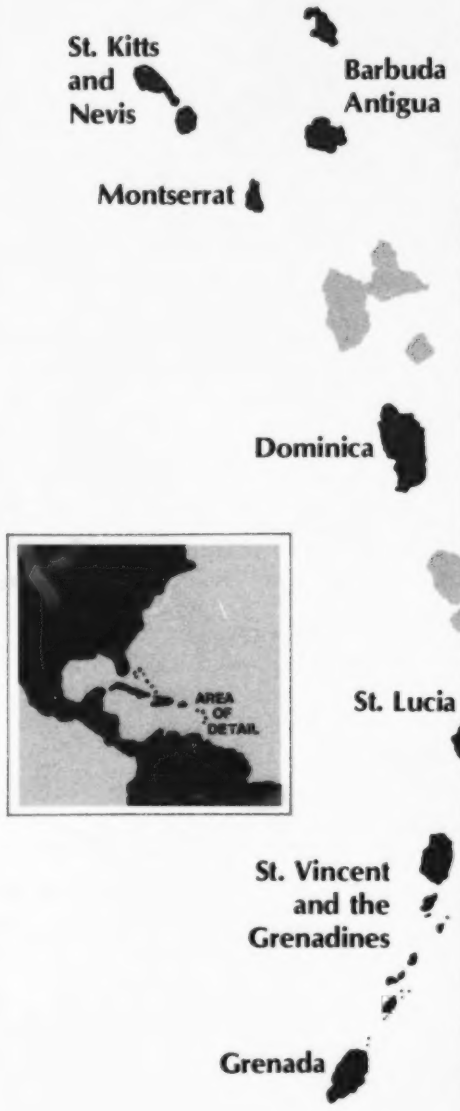
For them, the 1980s were a period of expansion unparalleled in over two decades. High GDP growth and gross investment levels were accompanied by structural shifts from low productivity or comparatively disadvantageous activities, like agriculture, to more advantageous ones, like manufacturing and services. Services — mainly tourism — now account for more than two thirds of economic activity on all seven islands.

The boom was fuelled by private investment. Whether foreign or domestic, private capital now accounts for 70 per cent of all investment in the OECS and for over 26 per cent of GDP.

Foreign investors were drawn by the prospects of the OECS, CARICOM and US markets. In all three, trade agreements grant protection or preferential entry to goods produced in the OECS. Investments were located particularly in export-oriented, labour-intensive activities, like garments and sewn products, manufacturing, electronics assembly, food processing and tourism. US firms were by far the leading investors in the manufacturing sector; the United States became the prime market for OECS manufactured goods.

The most dramatic increase, however, was in indigenous private sector investment. In just five years, 1980-85, local private investment quadrupled, surging from 14 to 51 per cent of total private investments.

Unlike foreign investment, local private investment is directed primarily to the domestic OECS market. This market is highly protected through tariff and administrative instruments, insulating domestic firms from the competitive pressures faced by foreign, export-oriented enterprises. Investors have flocked to the booming services sector. Here start-up costs are much less and lower price sensitivity makes the sector more profitable. Due largely to non-competitive production technologies and inadequate marketing know-how, OECS firms have not been



Development to Attract Investors

successful in breaking into foreign markets.

. . . but declining attractiveness to foreign investments

Despite continuing jumps in overall levels of private investment, capital inflows into the OECS began to decelerate after 1985. Foreign investors' share of private investment totals dropped from 86 to 49 per cent, as local investors' share rose.

Declining investor interest reflects the deteriorating comparative advantage of the OECS as an offshore location.

Not that this is worrisome in itself. What has caused the OECS concern is that the deceleration in foreign investment flows has been paralleled by a drop in manufactures exports and foreign exchange earnings. It underlines a strong link between investment from abroad and foreign manufactures sales.

The decline in investor interest, say foreign firms, is due to the deteriorating comparative advantage of the OECS as an offshore location to produce for the international market place. Over the 1980s, real wages have quadrupled without matching increases in productivity. Enterprises are facing reduced profitability in exporting to price comparative markets. Also cited is the lack of readily available factory space.

But 83 per cent of 122 firms interviewed for a UNCTC study see the lack of trained technical and management personnel as the leading hurdle to competitive production. Over 80 per cent are experiencing severe setbacks, including high plant under-utilization. Low technological development, they say, hinders the use of more advanced production technologies which could boost productivity and compensate for the increase in labour costs.

Skills and Know-how: a New Competitiveness Factor

If an export-oriented strategy is to be pursued in the OECS, technology upgrading and human resource development must be an essential part of international competitiveness building.

Over the last 15 years, the main instrument used by the OECS to attract foreign investment has been the Harmonized Fiscal Incentives Scheme. While initially successful in attracting foreign capital, the Scheme neglects to address important longer-term considerations, says the UNCTC study. For one, it is not designed to stimulate human resource development by requiring training of local personnel, or higher level management participation by OECS nationals. Neither has investment promotion been sensitive enough to the urgency of making enough workers available for higher technology jobs. Depreciation allowance for reinvestment or tax write-offs is negligible. Consequently, many enterprises operate with inefficient and antiquated technologies.

Neither does the Scheme encourage joint ventures, which in other developing countries are the chief tool for building local technological capacity. Incoming investments in the OECS are generally 100 per cent foreign owned, with a limited managerial role for nationals. Most major contracts in engineering and management consulting are executed by foreigners without any local participation.

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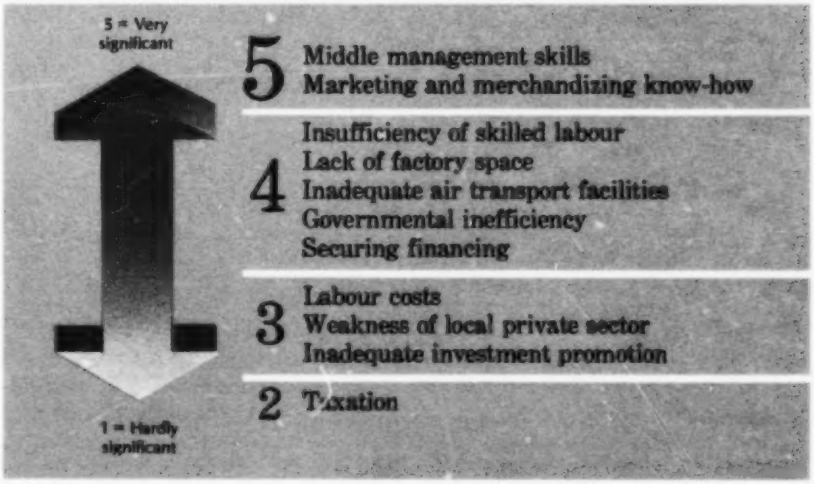
Investor Survey: What are the disincentives to locating in the OECS?



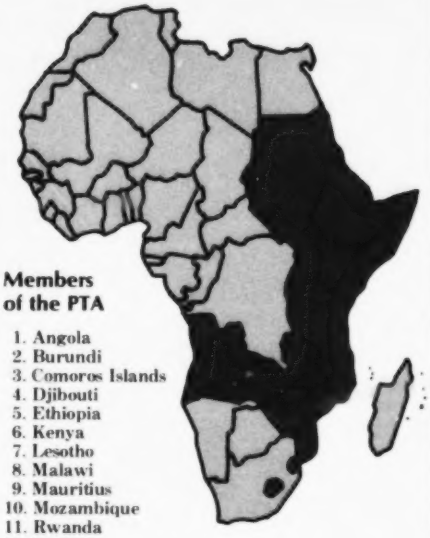
Regional Investment Regime in East Africa

Furthering an ongoing programme of subregional economic integration, 18 Eastern and Southern African States have brought into existence a new investment regime that encourages businessmen to establish firms on a regional rather than a national basis. These regional firms will enjoy a range of benefits, including a legal status derived from the economic grouping as a whole, not the laws of any one country. By having special opportunities, it is hoped these "multinational industrial enterprises" (MIEs) will generate more foreign exchange, new employment and an expansion of subregional trade.

The Charter on Multinational Enterprises was adopted by consensus at the annual meeting of the Preferential Trade Area (PTA) of Eastern and Southern African States last November. The PTA was set up in 1982 to enhance subregional economic growth through the setting up of a regional common market and the joint development of natural resources, industry, technology and manufacturing.

The new investment regime encourages investors to establish firms on a regional rather than a national level.

The new regime will allow investors from the PTA region and elsewhere and Governments party to the Charter to form regional MIEs. Enterprises may set up branches and subsidiaries in all signatory States and may operate across all industrial sectors. Existing regional companies may also set up multinational enterprises by creating joint subsidiaries or by merging.



Members of the PTA

1. Angola
2. Burundi
3. Comoros Islands
4. Djibouti
5. Ethiopia
6. Kenya
7. Lesotho
8. Malawi
9. Mauritius
10. Mozambique
11. Rwanda
12. Somalia
13. Sudan
14. Swaziland
15. Tanzania
16. Uganda
17. Zambia
18. Zimbabwe

For a company to qualify for MIE status, a national from one of the Charter States must hold at least 51 per cent of equity capital. Capital from any one source must not exceed 80 per cent of equity, and each contributor to the enterprise must hold at least 10 per cent.

MIEs are guaranteed the right to remit royalties and dividends to foreign countries. They are exempt from income taxes and import duties in the first five years of operation. They are also granted preferential tariff and non-tariff treatment with respect to a range of products.

Moreover, the regime assures investors that where an enterprise is nationalized or expropriated, the State concerned shall pay compensation in accordance with "generally accepted rules of international law". While member States may introduce administrative requirements, they are legally required to grant the whole range of benefits of the Charter to MIEs operating in their territories. All benefits conferred to individual enterprises cannot be modified without its consent.

In return, each MIE is expected to undertake a programme of production that will contribute to regional development goals. Enterprises are to gradually increase value-added, to produce goods at competitive prices and refrain from certain restrictive business practices. They are obligated, as much as is feasible, to provide training for employees. Regular disclosure of financial, operations and share ownership information is also required.

The obligations entered into by each enterprise with its host State, together with the general operation of the overall scheme, will be monitored both by the host State and the main organs of the Preferential Trade Area.

The new investment regime is designed to attract indigenous and foreign capital into certain key developmental areas. Among these are metal engineering, chemicals and fertilizers, agriculture and allied industries. Foreign investment is intended to be a key element in the initial stages, but among the scheme's ultimate objectives is the development of indigenous entrepreneurial resources and expertise in the subregion.

Over the last four years, UNCTC has actively provided technical assistance to the PTA secretariat in connection with this project, and with the harmonization of investment codes. It is expected that the Charter's entry into force will give a noticeable boost to current regional integration efforts in Eastern and Southern Africa. ■

Eastern Caribbean

(Continued from page 5)

And though services now account for over 60 per cent of GDP in the OECS, and are targeted as the main growth industry, the Scheme has no specific provisions in this area. In addition, incentives are geared almost wholly to US firms and the US market, overlooking the Europeans and the Japanese.

About the Study

The challenge for a new incentives scheme is to broaden and fine-tune benefits to encourage investment in plant upgrading, reinvestment, export sales and increased local value-added, and to appeal to a wider range of investors. Benefits could include, suggests the UNCTC study, tax credits for reinvestment, export financing and a rebate on the cost of overseas marketing. Also being proposed, within the OECS, is an industrialization strategy incorporating foreign distribution of local firms' output by international marketing companies.

A strategy to distribute local firms' output by international marketing firms is proposed.

Initiated in 1989, with funds from UNDP, the four-volume study is part of an ongoing UNCTC programme of technical assistance to the countries in the Caribbean subregion. It was commissioned to aid the harmonization of OECS policies, laws and regulations on foreign investment and transfer of technology. Among other things, the study sets out guidelines for negotiating bilateral investment treaties, double taxation treaties, and technology transfer and management agreements. ■

Free Economic Zones in Eastern Europe

In the last few years, a number of Central and Eastern European countries have set up free economic zones: enclaves where private foreign or domestic investors can produce directly for local consumers or export abroad. Among such countries are Bulgaria, Hungary and Yugoslavia. Poland passed enabling legislation in 1989. The Soviet Union followed the next year.

In Central and Eastern Europe, free economic zones are intended to complement older joint venture programmes by expanding the range of investment options available to both foreign and domestic enterprises. As with joint ventures, the principal objective is the improvement of existing production technologies through foreign direct investment. But by providing special treatment and physical amenities to investors, free economic zones, it is thought, should attract more high-tech foreign capital. Additionally, they offer an opportunity to experiment with new organizational and management approaches.

By providing special treatment and physical amenities to investors, free economic zones should attract more high-tech capital.

By 1990, around 300 zones existed worldwide, providing employment for more than 1.5 million workers in developing countries. Exports from developing country zones, currently around $15 billion, could reach $25 billion by 1995. Of the many different types of zones in existence worldwide, the following could be particularly appropriate to the countries of Central and Eastern Europe.

- Duty free zones, generally located at the main interconnecting points of the world transportation system;
- Export processing zones;
- Technology development parks, which build on existing scientific and technological capacity, adding complementary foreign capital, equipment, technical know-how, managerial experience and commercialization and marketing skills;
- Free banking and other services zones, which are an instrument for strengthening those vitally important support activities to a country's growth;
- Import processing and import substitution zones, which could supply the consumers and enterprises of Central and Eastern Europe with the advanced products and technologies necessary to accelerate economic and social development.

A recently published UNCTC study examines the experience of different zones throughout the world. It deals with issues of relevance to developing countries before focusing on the special situation of the countries of Central and Eastern Europe. ■

The Challenge of Free Economic Zones in Central and Eastern Europe: International Perspectives. April 1991. Published in English. United Nations publication, Sales No. E.90.II.A.27. Price $75. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.

Accounting for Africa

A just published survey by UNCTC, the World Bank and the Internatinal Labour Office of accounting in Africa finds a worrying situation. Of 37 countries surveyed, 18 — or one third of all African countries — have less than 50 fully qualified private sector accountants each. The public sector is even more understaffed.

Poor accounting education is the main stumbling block to developing the accounting profession in Africa, said the overwhelming majority of survey respondents.

Only 8 of the 37 countries surveyed offer a national certifying examination.

While in most countries training is available at the lower book-keeper and accounting technician levels, there is a critical shortage of courses at the professional level. Only 8 of the 37 countries surveyed — Algeria, Egypt, Kenya, Morocco, Nigeria, Tunisia, the United Republic of Tanzania and Zimbabwe — offer a national certifying examination. Moreover, practical training opportunities are limited, especially in industry and commerce.

Due mainly to the lack of fully trained local accountants, some transnational corporations are sending financial data back to headquarters for processing. In many countries, expatriates from major Western accounting firms dominate the local profession. While inefficient and expensive, the shortfall also limits host countries' ability to monitor growth and corporate performance.

Key Needs

- **More fully qualified accountants**
- **Improved public sector accounting**
- **Accounting education**
- **Locally adapted standards and systems**
- **Improved reporting**

Countries are making efforts to address the problem. In Swaziland, for instance, the Institute of Accountants is establishing an educational endowment trust, offering scholarships to students and higher salaries to lecturers to attract more professional accountants to teaching. Rwanda will provide in-house training organized in commercial banks. Mozambique is running a programme to develop corporate accounting systems and train individuals to operate them.

National accounting standards also require attention. In many countries, standards are lifted verbatim from outdated Western prototypes and require updating and adaption. Moreover, the sophistication of the legal and regulatory framework on accounting varies considerably. Tanzania and Zimbabwe, for instance, have detailed rules controlling the financial activities of the Government, parastatals, private businesses and individuals. Others, like the Gambia and Madagascar, have almost none.

Beginning later this year, UNCTC will assist a number of African countries in improving accounting training, promoting efficient accounting systems and enforcing accounting and auditing regulations. A regional meeting will be held in Dakar in June. ■

Accountancy Development in Africa: Challenge of the 1990s. **March 1991. United Nations publication, Sales No. E.91.II.A.2. Price $27.50. Also available, *International Accounting and Reporting Issues: 1990 Review*, Sales No. E.91.II.A.3. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.**

The United Nations Centre on Transnational Corporations is an autonomous body within the United Nations Secretariat. Under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council, the Centre seeks to further understanding of the nature of transnational corporations; to secure effective interpational agreements; and to strengthen the negotiating capacity of host countries, in particular the developing countries.

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Editor: Khalil Hamdani. Assistant Editors: Premila Nazareth and Christopher Smith.

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2 United Nations Plaza
New York, NY 10017, USA